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# DEMONETISATION AS A PRELUDE TO COMPLETE FINANCIAL INCLUSION

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## ABSTRACT

Financial Inclusion is a systematic effort to provide essential financial services to all and especially to poor people. The origins of the current approach to financial inclusion can be traced to the United Nations initiatives, which broadly described the main goals of inclusive finance as access to a range of financial services including savings, credit, insurance, remittance and other banking / payment services to all 'bankable' households and enterprises at a reasonable cost. The availability of quality financial services in rural areas is extremely important for the growth of the economy as this will enable the large number of rural households to fund the growth of their livelihoods. This concept has been pushed up by Government of India and RBI because even after so many years of independence high population of India remained unbanked . The main reason is majority of population lived in rural areas and they are not literate enough to understand the advantages of financial services. This paper focus on various initiatives taken by Government and RBI and also the latest attempt of demonetisation and its expecting impact on various sectors.

**KEYWORDS:** Financial Inclusion, Initiatives, Demonetisation, Impacts.

### INTRODUCTION

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way. Access to a transaction account is a first step toward broader financial inclusion since it allows people to store money, and send and receive payments. A transaction account can also serve as a gateway to other financial services, which is why ensuring that people worldwide can have access to a transaction account is the focus of the World Bank Group's Universal Financial Access 2020 initiative.As accountholders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives.[1]

### OBJECTIVES:

- To identify the need and significance of Financial Inclusion in India
- To highlight the measures taken by the Government of India and RBI for promoting financial inclusion
- To understand the importance of demonetisation as a measure of financial inclusion

### FINANCIAL INCLUSION IN INDIA:

Even after 60 years of independence, a large section of Indian population still remain unbanked. This malaise has led generation of financial instability and pauperism among the lower income group who do not have access to financial products and services. However, in the recent years the government and Reserve Bank of India has been pushing the concept and idea of financial inclusion.

### NEED AND SIGNIFICANCE OF FINANCIAL INCLUSION IN INDIA:

The policy makers have been focusing on financial inclusion of Indian rural and semi- rural areas primarily for three most important pressing needs:

- Creating a platform for inculcating the habit to save money
- Providing formal credit avenues
- Plug gaps and leaks in public subsidies and welfare programmes. [2]

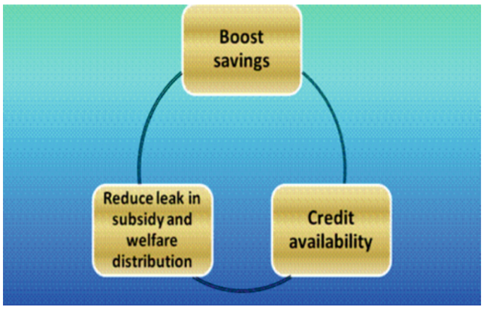


**Figure 1 shows the significance of Financial Inclusion in India**

The Reserve Bank of India setup a commission (Khan Commission) in 2004 to look into Financial Inclusion and the recommendations of the commission were incorporated into the Mid-term review of the policy (2005-06). In the report RBI exhorted the banks with a view of achieving greater Financial Inclusion to make available a basic "no-frills" banking account. In India, Financial Inclusion first featured in 2005, when it was introduced from a pilot project in UT of Pondicherry, by Dr. K. C. Chakraborthy, the chairman of Indian Bank.

### GOVERNMENT AND RBI INITIATIVES

The efforts to include the financially excluded segments of the society into formal financial system in India are not new. The concept was first mooted by the Reserve Bank of India in 2005. In 2006, RBI advised Banks to align their policies with the objective of financial inclusion, which saw the launch of basic banking 'No frills' account. Over the years, banks have introduced many innovations in the form of micro- ATMs, Basic Saving Bank Deposit accounts, kisan credit cards, general credit cards, and freedom prepaid cards, biometric cards, Business Correspondent Banking, relaxed KYC norms and simplified branch authorization policy, etc. to achieve financial inclusion.

In the last five years, the government's financial inclusion approach has undergone several changes. In 2011, the government launched 'Swabhimaan', another financial inclusion scheme focused on providing banking services to unbanked villages with a population greater than 2000. RBI also created a Financial Inclusion Fund (FIF) with a corpus of Rs 2,000 crore to support 'developmental and promotional activities' for expanding reach of banking services towards securing greater financial inclusion. While these initiatives have brought more people into the banking ecosystem, there is still a long way to go to achieve the vision of complete & comprehensive financial inclusion.

### PMJDY Scheme

Hon'ble Prime Minister, Sh.NarendraModi launched the PradhanMantri Jan-DhanYojana (PMJDY) scheme as a national mission for Financial Inclusion on 28th August, 2014. The objective of PMJDY scheme is to ensure affordable access of financial services to the vast sections of the disadvantaged and low-income groups. The financial services include credit, savings, insurance and payments and remittance facilities. As of 20th Jan 2016, more than 20 crore accounts with deposits in excess of 30,000 crore have been opened under the PMJDY scheme.

**Table1: PMJDY Progress Report (Accounts Opened as on 20.1.2016) (INR Cr)**

| Bank Name | Rural | Urban | Total | No.of Rupay cards | Aadhar Seeded | Balance in Accounts | % of zero balance accounts |
|---|---|---|---|---|---|---|---|
| Public Sector Banks | 8.91 | 7.10 | 16.01 | 13.82 | 7.46 | 24180.79 | 31.78 |
| RRB | 3.12 | 0.51 | 3.63 | 2.62 | 1.04 | 5286.66 | 26.24 |
| Private Banks | 0.45 | 0.30 | 0.74 | 0.70 | 0.24 | 1170.83 | 39.80 |
| Total | 12.47 | 7.91 | 20.38 | 17.14 | 8.74 | 30638.29 | 31.09 |

*Source: PMJDY Website*

The share of non-operative or zero balance accounts has fallen to 31.8% from 76.8% earlier. The significant drop in zero balance accounts indicates both increased transfers of central and state government subventions (NREGA, LPG subsidies, etc.) via these accounts, as well as development of a savings habit. Of the 20 crore accounts opened under the scheme, about 53 lakh have been offered the overdraft facility. But the overdraft was sanctioned for only around 27.5 lakh accounts, of which only around 12.3 lakh accounts availed this facility amounting to a disbursement of Rs.166 crore.

**Table 2 : Report on overdraft as per PMJDY scheme**

| Report on Overdraft as on 15.01.2016 | |
|---|---|
| Total No. of Accounts offered for OD | 53,54,075 |
| Total No. of Accounts OD Sanctioned | 27,56,516 |
| Total No. of Accounts OD Availed | 12,32,997 |
| Amount of Total OD Availed | Rs.166 Crored |

*Source: PMJDY Website*

**Role of Aadhaar**

It is witnessed that lack of documentation that they have to make available to establish their identity is a major challenge faced by Indian residents, especially the disadvantaged and low-income groups. To address this issue, 'Aadhaar' was introduced in 2009. An 'Aadhaar' card provides a 12-digit individual identification number, issued by the Unique Identification Authority of India (UIDAI), to serve as a proof of identity and address. Aadhaar is playing a vital role in the creation of a unified payment infrastructure to drive targeted and direct distribution of subsidies. Recently, the Supreme Court allowed the use of the Aadhaar number for disbursements of government entitlements under Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), the PradhanMantri Jan DhanYojana (PMJDY), central and state government pensions and the Employees' Provident Fund (EPF) scheme, in addition to the public distribution system (PDS) and distribution of liquefied petroleum gas (LPG) and kerosene. [3]

Direct transfer linked with the Unique Identity Card has resulted in a huge amount of substantial savings, which is used for the same section of the society. As part of its financial inclusion initiative, the government also has been giving huge amount of financial assistance to entrepreneurs.[4]

While these initiatives have brought more people into the banking ecosystem there is still a long way to go to achieve the vision of complete and comprehensive financial inclusion. Usage of digital accounts like debit/credit cards , point of sale (POS) machines , online banking, mobile financial services etc. remains debatable and very little data exists around this. As per the latest Financial Inclusion Insights survey, 49 percent of Indian adults are digitally included.

India's current episode of demonetisation has revealed the stark digital financial divide of the nation. Millions of people are crowding the banks and queuing outside ATM centers to deposit their cash before the deadline, revealing that India has a long way to go before it fully transitions into a digital financial economy. This is in part due to lower levels of digital financial literacy.[5]

**DEMONETISATION:**

Demonetization is the act of Banning /taking back of a currency unit of its status as legal tender. Demonetization is necessary whenever there is a change of national currency. The old unit of currency must be retired and replaced with a new currency unit.[6]

**HISTORY OF DEMONETISATION IN INDIA :**

**First Denom — 12 Jan 1946 (Source: RBI History 1935-51, pg 706)**

Following the action in several foreign countries, including France, Belgium and the U.K., the Government of India decided on demonetisation of high denomination notes, in January 1946. It is interesting that as early as April7, 1945, suggested similar action in India as 'one more concrete example for the Indian Government to follow in its fight against black market money and tax evasions which have now assumed enormous proportions .

**Second Denom — 16 Jan 1978 (Source: RBI History 1967-81, RBI Balance Sheet, RBI Currency and Finance Report)**

On 16 Jan 1978, the ordinance was announced via All India Radio at 9 AM.The Ordinance provided that all banks and government treasuries would be closed on 17 January 1978 for transaction of 'all business except the preparation and presentation or the receipt of returns' that were needed to be completed in the context of demonetization. This time public was given even lesser time of 3 days to exchange Rs 1000, Rs 5000 and Rs 10000 notes.[7]

**LATEST DEMONETISATION IN INDIA:**

The demonetisation of 500 and 1,000 banknotes was a policy enacted by the Government of India on 8th November 2016. All 500 and 1,000 banknotes of the Mahatma Gandhi series ceased to be legal tender in India from 9th November 2016. [8] In the announcement, Modi declared that use of all 500 and 1,000 banknotes of the Mahatma Gandhi Series would be invalid from midnight of the same day and announced the issuance of new 500 and 2,000 banknotes of the Mahatma Gandhi New series in exchange for the old banknotes. However, the banknote denominations of 100,50,20,10 and 5 of the Mahatma Gandhi Series remained legal tender and were unaffected by the policy.[9]

The move by the government to demonetize Rs.500 and Rs.1000 notes by replacing them with new Rs.500 and Rs.2000 notes aims to tackle the menace of black money, corruption, terror funding and fake currency. The total value of old Rs.500 and Rs.1000 notes in the circulation is to the tune of Rs.14.2 trillion, which is about 85% of the total value of currency in circulation.

The World Bank in July, 2010estimated the size of the shadow economy for India at 20.7% of the Gross Domestic Product (GDP)in 1999 and rising to 23.2% in 2007. Assuming that this figure has not risen since then (quite unlikely though) and that the cash component of the shadow economy is also proportional (it could be higher), the estimated unaccounted value of the currency could be to the tune of Rs.3.3 trillion. Now, post the announcement of demonetization by the government this money would have to either accounted for by paying the relevant tax and penalties or would get extinguished.

**The positive macro benefits of this move by the Government :**

This move by the government is likely to have long term benefits for the economy. The extinguishing of the major proportion of unaccounted currency would reduce from the liabilities of the government and would add to its finances. This would mean that while interest rates can be low, the government spending on large infrastructure projects would kickstart capex cycle and push economic growth higher in the medium term. The move is also likely to have a habit changing impact in the Indian populous and there could be increased belief of keeping cash in the banks rather than stashed at home and use formal banking channels for their spending needs. Also with more money being kept in the banking channel, some of these low cost deposits may be sticky and improve the medium to long term Current Account and Savings Account (CASA) ratio of the banks. Another element of the demonetization would be reduction in cash transactions in real estate. This is likely to reduce to real estate prices and make it affordable to some extent. This may be visible more in the rural belt, where many non-farming entities purchase fertile farmland, not for farming but for money parking purpose. The demonetisation and consequent reduction in shadow economy would bring the demand for such farm lands down. This move is likely to lead to better tax compliance, raise the Tax to GDP ratio and improved tax collection. Also with lower cash transactions in the near term, inflation may see downtrend in the near term. Also with higher tax to GDP ratio, the government may also get enough headroom to reduce the income tax rates, which can lead to higher disposable income with people and can improve consumption demand in the medium to long term.[10]

**IMPACTS OF DEMONETISATION:**

Here is an expecting effect of the demonetization on the GDP growth for the current financial year and the resulting cash crunch on various sectors, which are included for GVA estimation. The impact period considered is 7 weeks (from the of demonetization announcement on 8th November'16 till end of December'16). Certain projections have been made for the losses or gains in each sector week wise, which have been accounted for in final expected GVA for FY17 which will get reflected in the GDP growth number. A point to note is that some of the losses in GDP incurred in these 7 weeks (under Q3) will be recovered in the next quarter, particularly for consumer goods where there would be only deferment of purchase. However the same doesn't stand for losses in services sector. Nonetheless, the expected recoveries in Q4 have been netted off while considering the overall impact in these 7 weeks.

For individual sectors the proportion of output likely to be affected has been used as the basis for extrapolating the potential loss of output on a weekly basis till December end when it is assumed conditions normalizes. The impact hence varies across these 7 weeks with the intensity being highest in the first two weeks which keeps tapering downwards towards the end of the terminal period. As the judgments made on these effects is critical to assess potential loss of GVA, the methodology works on the basis of two alternative approaches which will help to formulate a range for the same.

***Conservative Approach***: Here the premise is that the expected impact is moderate as the assumption is that there would be minimal level of distortions on growth in output.

***Aggressive Approach***: In this model the assumption is that there would be extreme distortions to begin with which will subsequently taper down proportionately over time. This becomes significant especially in the services sector.

The services sector is expected to be affected the most under both the approaches, mainly on account of losses in trade, hotel, transport etc. due to the volume of cash transactions involved in these economic activities. Importantly, these losses, due to their inherent nature, can't be recovered in the next quarter.

- SMEs in industry will have a major problem in adjusting production schedules as both payments and receipts flow in cash given their structures.

- For rest of manufacturing, demand side issues would exist till such times conditions stabilize and could get reversed in Q4. Hence, Industry is also expected to be impacted which will be more significant in the first 2-3 weeks post the announcement.

- The gains would be positive for the banking sector due to the increase in deposits which would be countered by slowing down of other sectors in the group like real estate.

- Agriculture is expected to least impacted with major shock being absorbed in the first 2-3 weeks itself as there have been issues in sales at mand is due to the cash crunch presently. [11]

Even though it is not able to predict and calculate the impact of GDP in this current situation, these all are only an expectations. There are various opinions regarding the increasing and decreasing rate of GDP.

**CONCLUSION:**

The financial system in India has grown rapidly in the last three decades and more. The functional and geographical coverage of the system is truly impressive. Nevertheless, data do show that there is exclusion and that poorer sections of the society have not been able to access adequately financial services from the organised financial system. There is an imperative need to modify the credit and financial services delivery system to achieve greater inclusion. The latest solution is demonetisation. Even though there will be pain and confusion in the short term for common people and economy, a disruptive measure was perhaps the only way to shake up the system to a new compliance normal. It is expecting that demonetisation provides a boost to Government's financial inclusion drive.

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